

**Taxpayers' Refund Claims Received Near the  
Refund Statute Expiration Date Were  
Appropriately Processed, but Enhancements  
Could Be Made**

**August 2003**

**Reference Number: 2003-10-171**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

August 28, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in cursive script, reading "David R. Denker".

FROM: for Gordon C. Milbourn III  
Assistant Inspector General for Audit (Small Business and  
Corporate Programs)

SUBJECT: Final Audit Report - Taxpayers' Refund Claims Received Near  
the Refund Statute Expiration Date Were Appropriately  
Processed, but Enhancements Could Be Made  
(Audit # 200210038)

This report presents the results of our review of disallowed refunds. The overall objective of this review was to determine whether the Internal Revenue Service (IRS) was protecting taxpayer rights by complying with the Refund Statute Expiration Date (RSED) when processing refund claims. This review also determined whether the IRS was complying with the financial disability provision<sup>1</sup> enacted by the IRS Restructuring and Reform Act of 1998 (RRA 98).<sup>2</sup>

In summary, we found the IRS appropriately allowed refunds on returns received prior to the expiration of the RSED and appropriately disallowed refunds when returns were received after the expiration of the RSED. However, taxpayers were not always properly granted additional days when the RSED fell on a weekend or holiday or given the benefit of the postmark date when filing returns before the RSED. In addition, the letter sent to taxpayers when their refund claims were disallowed because of an expired RSED did not explain that the refund statute could be suspended because of a financial disability.

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<sup>1</sup> Internal Revenue Code (I.R.C.) § 6511 (1998).

<sup>2</sup> IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

We recommended that the Commissioner, Wage and Investment (W&I) Division, request the computer programming be changed to grant taxpayers the additional days in which to file a tax return when the RSED falls on a weekend or holiday and thereby eliminate the need to manually identify these instances. The programming should be accomplished before Calendar Year 2006, when April 15 next falls on a weekend. We also recommended that the Commissioner, W&I Division, issue refunds to the taxpayers whose refund claims we identified as being inappropriately disallowed and consider whether an additional control is needed to ensure Statute Unit employees appropriately considered the postmark date. In addition, we recommended that the Commissioner, W&I Division, revise the letter sent to taxpayers when refunds are disallowed due to the expiration of the RSED to include information about the financial disability provision.

Management's Response: IRS management agreed to initiate corrective actions for our recommendations. Specifically, the IRS has begun the process of issuing refunds it previously disallowed inappropriately and requested a computer programming change that allows the RSED to accommodate weekends and holidays. In addition, the IRS is evaluating whether an additional control is needed to ensure the Statute Unit employees appropriately considered the postmark date and is modifying the letter sent to taxpayers used to disallow refund claims to include conditions or situations that may extend the RSED. Although IRS management agreed with the recommendations, they disagreed with the number of taxpayers, 116,000, we stated were potentially burdened because the Letter 105C did not inform them of the financial disability provision. The IRS believes sufficient sources of information on financial disability are available to taxpayers who may qualify for this exception to the RSED requirements. In our opinion, the IRS could have better informed and educated these estimated 116,000 taxpayers if the Letter 105C contained information about the financial disability provision or directed them to applicable publications available. Therefore, we did not adjust our reported outcome measure. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

**Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were  
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## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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### **Background**

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The due date for an individual income tax return is generally April 15 following the end of the tax year. Taxpayers can file a tax return after the due date and still receive a refund, but there is a statute of limitations called the Refund Statute Expiration Date (RSED). A taxpayer can receive a refund if the Internal Revenue Service (IRS) receives the tax return within 3 years of the original due date or 2 years from the last tax payment made by the taxpayer, whichever is later.

The RSED can be extended if the taxpayer submits an extension of time to file, has a financial disability, or was in a combat zone or disaster area. When any taxpayer's RSED falls on a weekend or holiday, the IRS is required to allow the taxpayer to file on the next business day and be considered as timely filing. For example, the RSED for a Tax Year (TY) 1997 return was April 15, 2001; however, since it was a Sunday, taxpayers had until the next business day, April 16, 2001, to file their TY 1997 returns and receive the refunds.

Wage and Investment (W&I) Division Statute Unit employees screen returns before computer processing and review account transcripts after computer processing to determine if refund claims have been received prior to the expiration of the RSED. Also, Statute Unit employees manually identify and back date tax returns when the RSED falls on a weekend or holiday to allow taxpayers the additional day(s) to file. This allows the computer system to consider the tax returns as being received prior to the expiration of the RSED. In addition, the Internal Revenue Code (I.R.C.)<sup>1</sup> requires Statute Unit employees to use the postmark date when determining the received date for tax returns. When the postmark date is not available because the envelope is not attached or the date is not legible, Statute Unit employees are to consider a tax return as being timely filed if the IRS stamped received date was within 7 days after the RSED.

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<sup>1</sup> I.R.C. § 7502 (2002).

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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The IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>2</sup> added a provision that permits the suspension of the refund statute during any period a taxpayer is financially disabled. A financial disability is when the taxpayer is unable to manage his or her financial affairs because of a medically determinable physical or mental impairment. The medically determinable physical or mental impairment must be expected to result in death or have lasted, or be expected to last, for a continuous period of not less than 12 months. A taxpayer is not considered to have had an impairment unless proof of the existence of the financial disability is provided to the IRS.<sup>3</sup>

We conducted our review and interviewed W&I Division and Information Technology Services (ITS) function employees in the Memphis, Tennessee, New Carrollton, Maryland, Ogden, Utah, and Washington, D.C., IRS offices. Our work was performed from November 2002 through April 2003 in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### **The Statute Unit Appropriately Processed Taxpayer Refund Claims Received Before or After the Refund Statute Expiration Date**

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The Statute Unit protected taxpayer rights by appropriately allowing refunds on tax returns received prior to the expiration of the RSED and appropriately disallowing refunds when returns were received after the expiration of the RSED. In our computer analysis, the Statute Unit issued a refund in 106,854 of 107,876 instances when tax returns with overpayments were received prior to the expiration of the RSED.<sup>4</sup> Generally, the IRS is required to issue refunds on tax returns that are received before the RSED. In the remaining 1,022 cases, the Statute Unit appropriately

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<sup>2</sup> IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>3</sup> RRA 98 § 3202 amended I.R.C. § 6511 (1998) to allow for the suspension of the RSED for a financial disability.

<sup>4</sup> We did not include TY 1997 returns with a received date of April 16, 2001, because an RSED falling on a Sunday is discussed in another section of the report.

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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disallowed 937 refunds because of incomplete or incorrect information. However, the Statute Unit inappropriately disallowed 85 refund claims received before the RSED. These exceptions were confirmed with W&I Division officials. The total amount due these taxpayers is approximately \$85,000, plus interest of approximately \$11,000.<sup>5</sup>

In our computer analysis, the Statute Unit disallowed refunds in 134,488 of 149,552 instances when returns with overpayments were received after the RSED. Generally, the IRS is required to disallow refunds when a return is received after the RSED. A sample of 502 of the remaining 15,064 cases indicated that the Statute Unit correctly allowed 468 refunds and incorrectly allowed 34 refunds. These exceptions were confirmed with W&I Division officials.

Based on the small error rate and the effectiveness of the Statute Unit internal controls over the processing of returns, we did not identify any systemic or procedural changes that could have prevented these errors from occurring.

### **Recommendation**

1. The Commissioner, W&I Division, should issue taxpayers refunds with interest in the 85 instances where we found refunds were inappropriately disallowed before the RSED. To avoid confusion, these taxpayers should be provided an explanation of why the refunds are being issued.

Management's Response: W&I Division management plans to post a credit to each of the 85 taxpayer accounts and issue a refund if there are no unpaid debts owed to the Federal Government. Also, each taxpayer will be sent a letter explaining why the IRS corrected his or her account.

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<sup>5</sup> Interest computed through March 31, 2003.

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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### **When the Refund Statute Expiration Date Fell on a Sunday, Taxpayers Were Not Always Appropriately Granted an Additional Day to File**

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In 2001, when April 15 fell on a Sunday, taxpayers were not always granted the additional day (April 16, 2001) to file TY 1997 returns. When a taxpayer's RSED falls on a weekend or holiday, the IRS is required by the I.R.C.<sup>6</sup> to allow the next day that is not a weekend or holiday for the taxpayer to file his or her return. In our computer analysis, the IRS initially disallowed 2,022 TY 1997 returns with refund claims filed on April 16, 2001. Our computer analysis also indicated that subsequently the Statute Unit corrected 1,763 of these refund claims. However, Statute Unit processing did not identify 227 taxpayers with refund claims filed on April 16, 2001, that should have been granted the additional day to file. Therefore, these taxpayers were inappropriately disallowed their refunds. These exceptions were confirmed with W&I Division officials. In the remaining 32 instances, the Statute Unit properly disallowed 25 taxpayer refunds because of incomplete or incorrect information. In the last seven cases, we could not obtain the necessary documentation to evaluate the TY 1997 returns.

To allow taxpayers the additional day to file, the Statute Unit processing procedures require employees to attempt to identify when the RSED falls on a weekend or a holiday. In 2001, Statute Unit employees screened tax returns to manually identify and back date TY 1997 return received dates from April 16, 2001, to April 15, 2001, before computer processing. This allowed the computer system to consider the TY 1997 returns as timely filed. After computer processing, the Statute Unit's processing identified and corrected additional instances of TY 1997 returns timely filed on April 16, 2001. The Statute Unit reviewed account transcripts when the computer system disallowed refund claims based on the RSED to ensure the disallowance of the refunds was appropriate.

The IRS' computer system currently does not grant taxpayers the next business day to file a return when the RSED falls on a weekend or holiday. An ITS function computer programmer confirmed that the computer

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<sup>6</sup> I.R.C. § 7503 (2002).



## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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programming for the RSED does not consider weekends and holidays but indicated such changes can be made.

Computer programming could eliminate the need for Statute Unit employees to manually identify instances when the RSED falls on a weekend or holiday to allow taxpayers the additional day(s) to file. When a taxpayer's RSED falls on a weekend or holiday, revised computer programming would help assure the taxpayer is always appropriately granted the required additional business day(s) to file for and receive his or her refund. The computer could have processed the 227 returns and provided the taxpayers refunds of approximately \$210,000. Also, since these refunds have not been issued, the IRS is required to pay additional interest of about \$28,000.<sup>7</sup>

Revised computer programming would have resulted in taxpayers receiving their refunds timely and prevented the IRS from having to pay interest. The I.R.C.<sup>8</sup> requires the IRS to pay taxpayers interest when refunds are issued more than 45 days after the IRS has received a tax return. The Statute Unit identified, corrected, and issued these 1,763 refunds for TY 1997 returns. However, the IRS had to pay approximately \$37,000 in additional interest.<sup>9</sup>

The next time April 15 falls on a weekend is in the year 2006. April 15 is the RSED for most tax returns, although it is possible for the RSED to fall on any day of the year because of extensions and suspensions. The completion of the computer programming to recognize weekends and holidays by the year 2006 will enable the IRS to protect taxpayer rights by correctly issuing taxpayer refunds. In addition, it would save Statute Unit employees from working some refund claims and save Federal Government funds paid out in interest.

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<sup>7</sup> Interest computed through March 31, 2003.

<sup>8</sup> I.R.C. § 6611(e) (2002).

<sup>9</sup> Actual interest paid on the 1,763 taxpayer accounts.

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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### **Recommendations**

2. The Commissioner, W&I Division, should issue taxpayers refunds with interest for the 227 instances we found in which TY 1997 returns were timely received on April 16, 2001, but were inappropriately disallowed. To avoid confusion, these taxpayers should be provided an explanation of why the refunds are being issued.

Management's Response: W&I Division management plans to post a credit to each of the 227 taxpayer accounts and issue a refund if there are no unpaid debts owed to the Federal Government. Also, each taxpayer will be sent a letter explaining why the IRS corrected his or her account.

3. The Commissioner, W&I Division, should request a computer programming change that allows the RSED to accommodate weekends and holidays.

Management's Response: W&I Division management plans to submit a Request for Information Services to have the necessary programming changes made prior to Calendar Year (CY) 2006. CY 2006 is the next year in which April 15 falls on a weekend.

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### **When Granting Taxpayers' Refunds, the Statute Unit Did Not Always Appropriately Consider Postmark Dates or Received Dates**

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The I.R.C.<sup>10</sup> requires the use of the postmark date when determining the received date for tax returns. This was critical for taxpayers claiming refunds with returns that the IRS received shortly after the RSED. As a hypothetical example, assume the IRS received a TY 1997 return on April 17, 2001, with a postmark date of April 14, 2001. Since the RSED for a TY 1997 return was April 16, 2001, because April 15, 2001, fell on Sunday, the postmark date of April 14, 2001, should have been used as the received date. Using the received date of April 14, 2001, would have allowed the computer system to issue the taxpayer a refund. Conversely, if this postmark date was not used, the taxpayer would have been inappropriately disallowed his or her refund.

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<sup>10</sup> I.R.C. § 7502 (2002).

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Tax returns with received dates near the RSED were sent to the Statute Unit for review, including verification that the received date matched the postmark date. The Statute Unit has procedures for when the postmark date is not available because the taxpayer's envelope has been lost or the postmark date is illegible. Employees date stamp tax returns when the IRS receives them. When the postmark date can not be used, employees are to consider a return as being timely received if the IRS-stamped received date is within 7 days after the RSED.

The I.R.C. requirement of using the postmark date to determine the appropriate received date has been in place since 1954. The IRS clarified the use of postmark procedures in response to a July 2000 United States Court of Appeals decision.<sup>11</sup> The IRS also performed a recovery program to retroactively grant taxpayer refunds previously denied for 1995 and 1996 tax returns with an IRS-received date within 7 days after the RSED. The Statute Unit procedures were revised on February 13 and March 8, 2001, to prevent future refunds from being inappropriately disallowed.

The IRS disallowed 4,486 refund claims on TY 1997 returns received within 7 days after the RSED. A majority of these refund claims were received between April 16 and April 22, 2001.<sup>12</sup> A sample of 425 of these refund claims indicated that 272 were inappropriately disallowed. Approximately one-half of the disallowed refund claims had postmark dates before the expiration of the RSED. In the other half of the disallowed refund claims, the postmark date was not available, but the received date was within 7 days after the RSED. These 272 exceptions were confirmed with W&I Division officials.

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<sup>11</sup> Weisbart v. United States Department of Treasury and Internal Revenue Service, 222 F.3d 93 (2d Cir. 2000) rev'g 99-1 USTC (CCH) para. 50, 549 (E.D.N.Y. 1999), AOD-CC-2000-09 (November 13, 2000) Weisbart v. United States Department of Treasury, 222 F.3d 93 (2d Cir. 2000).

<sup>12</sup> We did not include TY 1997 returns with a received date of April 16, 2001, because an RSED falling on a Sunday is discussed in another section of the report.

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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As of March 31, 2003, the IRS owed these 272 taxpayers approximately \$617,000 in refunds and nearly \$73,000 in interest that continues to accrue. We estimate that 2,830 taxpayers were inappropriately disallowed refunds totaling approximately \$3.1 million and nearly \$385,000 in interest for the entire population.

This condition occurred because Statute Unit employees did not always use the postmark date to determine an accurate return received date. In 213 of the 272 disallowed refund claims we identified, Statute Unit employees had not correctly used the postmark date. The remaining 59 returns did not contain indications the Statute Unit initially reviewed the returns.

Although Statute Unit cases were quality reviewed, these errors would not have been identified to allow Statute Unit managers to take action to correct trends of errors. Cases selected for quality review would have been evaluated to determine if employees correctly handled statute issues. However, the guidelines did not specifically state that quality reviewers should evaluate whether employees appropriately considered the postmark date and, if no postmark date was available, whether employees considered if the IRS-received date was within 7 days after the RSED. Statute Unit employees made the majority of these errors in 2001. Since the quality review process did not specifically evaluate whether employees considered the postmark date or the received date and there are no other specific data available, we do not know whether this condition continues to exist.

### **Recommendations**

4. The Commissioner, W&I Division, should issue refunds with interest to the estimated 2,830 taxpayers that had their refunds inappropriately disallowed because Statute Unit employees did not correctly identify appropriate postmark dates before the expiration of the RSED or the IRS-received date was within 7 days after the RSED. To avoid confusion, these taxpayers should be provided an explanation of why the refunds are being issued.

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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Management's Response: W&I Division management has established a process to review the 4,486 TY 1997 returns that were received within 7 days after the RSED. They plan to correct any taxpayer account having an inappropriately denied refund by posting a credit to the account and refunding it if there are no unpaid debts owed to the Federal Government. Also, each taxpayer will be sent a letter explaining why the IRS corrected his or her account.

5. The Commissioner, W&I Division, should evaluate whether an additional control is needed to ensure Statute Unit employees appropriately considered the postmark date and, if no postmark date was available, whether they determined the IRS received date was within 7 days after the RSED.

Management's Response: W&I Division management plans to review their current procedures and determine if additional controls are needed.

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### **Taxpayers With Disallowed Refund Claims Were Not Informed of the Financial Disability Provision**

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The letter used to inform taxpayers that their refund claims were disallowed because of an expired RSED (Letter 105C) did not include language explaining that the refund statute could be suspended because of a financial disability. If taxpayers qualified for financial disability, their refund statute would have been suspended, and they would still be able to claim their refunds. The RRA 98 added a provision that requires the IRS to suspend the running of the refund statute during any period a taxpayer is financially disabled.

A financial disability is when the taxpayer is unable to manage his or her financial affairs because of a medically determinable physical or mental impairment. The medically determinable physical or mental impairment must be expected to result in death or have lasted, or be expected to last, for a continuous period of not less than 12 months. A taxpayer is not considered to have an impairment unless proof of the existence of the financial disability is provided to the IRS.

The 250 letters we reviewed that were sent to taxpayers when refunds were disallowed because the RSED had expired did not contain any information concerning

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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suspension of the statute due to financial disability. In our computer analysis, the Statute Unit disallowed refunds for 139,119 returns filed during CY 2001. Based on our sample review of tax returns, we estimate that approximately 116,000 taxpayers were potentially burdened because the letters the Statute Unit issued did not explain financial disability. We did not determine whether any of the 116,000 taxpayers were actually entitled to receive their refunds because of a financial disability.

Although the IRS revised educational materials available to the public about financial disability in various publications<sup>13</sup> and instructions,<sup>14</sup> it did not identify and revise the Letter 105C. By not revising the Letter 105C, the IRS missed a primary opportunity to inform taxpayers about financial disability. During discussions with W&I Division personnel, we determined changes to the Letter 105C for financial disability were not considered.

### **Recommendation**

6. The Commissioner, W&I Division, should include information in the Letter 105C to inform taxpayers that their refund statute could be suspended in the event of a financial disability and refer them to IRS Publications 17 or 556.

Management's Response: W&I Division management plans to modify Letter 105C and include a general statement that certain situations and conditions may extend the RSED. They will refer the taxpayer to Publication 556 or to a brochure developed from that publication, which they will enclose with Letter 105C.

Office of Audit Comment: The Commissioner, W&I Division, agreed with the recommendation to this finding; however, he disagreed with the number of taxpayers, 116,000, we stated were potentially burdened

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<sup>13</sup> *Your Federal Income Tax For Individuals* (Publication 17), page 21 (2002) and *Examination of Returns, Appeal Rights, and Claims for Refund* (Publication 556), pages 20-24 (2002).

<sup>14</sup> Form 1040 Instructions, page 52 (2002); Form 1040A Instructions, page 50 (2002); and Form 1040EZ Instructions, page 22 (2002).

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because the Letter 105C did not inform them of the financial disability provision. The IRS believes sufficient sources of information on financial disability are available to taxpayers who may qualify for this exception to the RSED requirements. In our opinion, the IRS could have better informed and educated these estimated 116,000 taxpayers if the Letter 105C contained information about the financial disability provision or directed them to applicable publications available. Therefore, we did not adjust our reported outcome measure.

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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### **Appendix I**

#### **Detailed Objective, Scope, and Methodology**

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) was protecting taxpayer rights by complying with the Refund Statute Expiration Date (RSED) when processing refund claims. This review also determined whether the IRS was complying with the financial disability provision<sup>1</sup> enacted by the IRS Restructuring and Reform Act of 1998 (RRA 98).<sup>2</sup> To accomplish our objective, we performed the following tests:

- I. To determine what guidance has been provided to IRS employees and taxpayers regarding refund claims and the RSED, we reviewed the Internal Revenue Code, the Internal Revenue Manual, other directives issued to IRS personnel, publications and instructions available to taxpayers, notice templates used by the IRS, and a Tax Court Decision. We also reviewed quality and managerial review procedures and training provided to employees.
- II. To determine whether the IRS appropriately issued taxpayer refunds, we used a computer Master File<sup>3</sup> extract to identify and review the 1,022 instances in which returns had a received date before the RSED, but the refund had been disallowed.<sup>4</sup>
- III. To determine whether the IRS was appropriately issuing taxpayer refunds when Tax Year (TY) 1997 returns were filed on April 16, 2001, we used a computer Master File extract to identify and review the 2,022 TY 1997 returns that were received on April 16, 2001, and had refunds disallowed. The RSED for the TY 1997 return was Sunday, April 15, 2001; therefore, the taxpayers were granted an additional day, Monday, April 16, 2001, to file a timely refund claim.
- IV. To determine whether the IRS was appropriately issuing taxpayer refunds, we used a computer Master File extract to identify the 15,064 returns that had a received date after the RSED, but the refund claim was allowed, and then reviewed a statistical random sample of 502 of the refund claims. See Appendix IV for additional information about our statistical sampling methodology for Steps IV., V., and VI.

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<sup>1</sup> Internal Revenue Code § 6511 (1998).

<sup>2</sup> IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>3</sup> The IRS database that stores various types of taxpayer information. This database includes individual, business, and employee plans and exempt organizations data.

<sup>4</sup> We did not include Tax Year 1997 returns with a received date of April 16, 2001, because an RSED falling on a Sunday is included in a different audit test.



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- V. To determine whether the IRS appropriately provided taxpayers with information concerning financial disability, we used a computer Master File extract and identified 139,119 returns that had refunds disallowed because the RSED had expired. We manually reviewed a statistical random sample of 300 returns to determine if the Letter 105C<sup>5</sup> included information concerning financial disability.
- VI. To determine whether the IRS was potentially violating taxpayers' rights by not using the correct return received date, we used a computer Master File extract to identify the 4,486 TY 1997 returns that had a received date 7 days after the RSED and the refund was disallowed.<sup>6</sup> We manually reviewed a statistical random sample of 425 returns to determine whether the returns had a postmark date prior to the RSED or, if the postmark date was not available, the received date was within 7 days after the RSED. We also reviewed the quality review process used by the Statute Unit to identify this type of error.

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<sup>5</sup> Computer-generated letter sent to a taxpayer when a refund is denied.

<sup>6</sup> We did not include TY 1997 returns with a received date of April 16, 2001, because an RSED falling on a Sunday is included in a different audit test.

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**Appendix II**

**Major Contributors to This Report**

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Mary V. Baker, Director

Aaron R. Foote, Audit Manager

Mark A. Judson, Senior Auditor

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**Appendix III**

**Report Distribution List**

Commissioner N:C  
Deputy Commissioner for Operations Support N:OS  
Deputy Commissioner for Services and Enforcement N:SE  
Director, Customer Account Services W:CAS  
Director, Strategy and Finance W:S  
Director, Accounts Management W:CAS:AM  
Director, Submission Processing W:CAS:SP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O  
Office of Management Controls N:CFO:AR:M  
Audit Liaisons:  
    Commissioner, Wage and Investment Division W  
    Director, Customer Account Services W:CAS

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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### **Appendix IV**

#### **Outcome Measures**

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

##### Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 85 taxpayers due \$85,000 in refunds that were inappropriately disallowed on tax returns received prior to the expiration of the Refund Statute Expiration Date (RSED) (see page 2).
- Cost Savings (Funds Put to Better Use) – Actual; \$11,000 in interest due the 85 taxpayers that had refund claims inappropriately disallowed (see page 2).

##### Methodology Used to Measure the Reported Benefit:

Using an extract from the Internal Revenue Service's (IRS) Master File,<sup>1</sup> we identified and reviewed the 1,022 tax returns received between January 1 and December 31, 2001, that had a return received date prior to the RSED and an overpayment that was not refunded to the taxpayer. We did not include Tax Year (TY) 1997 returns with a received date of April 16, 2001, because an RSED falling on a Sunday is included in another area of the report. We reviewed Master File transcripts<sup>2</sup> and related tax documents for the 1,022 tax returns and identified 85 taxpayer accounts owed refunds of \$85,000 which were inappropriately disallowed. We determined that the 85 taxpayers were also entitled to approximately \$11,000 in interest, calculated through March 31, 2003.

##### Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 227 taxpayers with \$210,000 in refunds that had refund claims inappropriately disallowed because the taxpayers were not granted the additional business day to file their tax returns when the RSED fell on a weekend or holiday (see page 4).
- Cost Savings (Funds Put to Better Use) – Actual; \$28,000 in interest due the 227 taxpayers that had refund claims inappropriately disallowed (see page 4).

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<sup>1</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

<sup>2</sup> Master File transcripts are an itemized listing of actions taken on an account.

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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### Methodology Used to Measure the Reported Benefit:

Using the extract from the IRS' Master File, we identified and reviewed the 2,022 TY 1997 returns with an April 16, 2001, received date that had overpayments that had not been refunded to the taxpayers. We reviewed Master File transcripts and related tax documents and identified 227 taxpayers that had refund claims of \$210,000 inappropriately disallowed because they had not been granted the additional day to file because April 15, 2001, fell on a Sunday. We determined that the 227 taxpayers were also entitled to approximately \$28,000 in interest, calculated through March 31, 2003.

### Type and Value of Outcome Measure:

- Costs Savings (Funds Put to Better Use) – Actual; \$37,000 of interest paid relating to 1,763 taxpayers whose refunds were delayed because processing procedures required the Statute Unit employees to identify and correct these returns so the refunds could be issued (see page 4).

### Methodology Used to Measure the Reported Benefit:

Using the extract from the IRS' Master File, we identified and reviewed the 2,022 TY 1997 returns with an April 16, 2001, received date that had overpayments that had not been refunded to the taxpayers. We reviewed Master File transcripts and related tax documents and determined that 1,763 taxpayer accounts were paid \$37,000 in interest because their refunds were not issued within 45 days of the IRS' receipt of the returns. The refunds were delayed while the Statute Unit employees identified and corrected the returns so that the refunds could be issued to the taxpayers.

### Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 2,830 taxpayer accounts with approximately \$3.1 million in refunds inappropriately denied because the returns were not given the benefit of the postmark dates or received dates (see page 6).
- Cost Savings (Funds Put to Better Use) – Potential; \$385,000 in interest due the projected 2,830 taxpayer accounts mentioned in the previous outcome measure (see page 6).

### Methodology Used to Measure the Reported Benefit:

Using the extract from the IRS' Master File, we identified and reviewed TY 1997 returns with return received dates that were within 7 days after the RSED. We did not include TY 1997 returns with a received date of April 16, 2001, because an RSED falling on a Sunday is included in another area of the report. We identified 4,486 TY 1997 returns that had a received date within 7 days after the RSED and had a refund disallowed.

We reviewed a statistically valid sample of 425 of the 4,486 taxpayer accounts to determine whether the postmark date was prior to the expiration of the RSED. For the taxpayer accounts selected in our samples, we obtained tax documents to determine whether the postmark date was

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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used or, if no postmark date was available, the received date was within 7 days after the RSED. We found 272 taxpayers were due approximately \$617,000 in refunds because the Statute Unit had not appropriately considered the postmark dates or the received dates. Using a 95 percent confidence level, we estimate that 2,830 taxpayers (+/- 4.4 percent) were inappropriately disallowed refunds totaling approximately \$3.1 million (+/- 8.1 percent). Using the 2,830 taxpayer accounts and based on a 95 percent confidence level, we estimate that these taxpayers are entitled to approximately \$385,000 (+/- 7.8 percent) in interest, calculated through March 31, 2003.

### Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 116,000 taxpayers received a Letter 105C disallowing a refund because the RSED had expired, but the letters did not inform them of the financial disability provision (see page 9).

### Methodology Used to Measure the Reported Benefit:

Using the extract from the IRS' Master File, we identified 139,119 TY 1997 and prior year returns with received dates between January 1 and December 31, 2001, that had a refund disallowed.

We reviewed a statistically valid sample of 300 of the 139,119 taxpayer accounts to determine whether taxpayers received a letter that contained information concerning the financial disability provision. We identified 250 taxpayer letters and, using a 95 percent confidence level, estimate that 116,000 taxpayers (+/- 4.21 percent) received a letter disallowing the refund because the RSED had expired, but the letters did not contain information concerning the financial disability provision. We did not determine whether any of the 116,000 taxpayers were actually entitled to receive their refunds because of a financial disability.

**Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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**Appendix V**

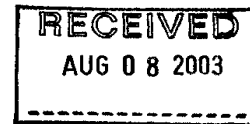
**Management's Response to the Draft Report**



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

August 8, 2003



**MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX  
ADMINISTRATION**

**FROM:**

Henry O. Lamar, Jr.  
Commissioner, Wage and Investment Division

**SUBJECT:**

Draft Audit Report – Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed but Enhancements Could Be Made (Audit No. 200210038)

I am pleased that you concluded the IRS is correctly administering the provisions of the law dealing with the Refund Statute Expiration Date (RSED). We have worked hard to protect taxpayer rights by allowing refunds on tax returns received prior to the RSED and denying refunds when returns are received after the RSED. Your report provides us with insight on how to increase our effectiveness when dealing with refund statute situations that are outside the norm. We appreciate your efforts to identify those taxpayers who should have their accounts adjusted. We are reviewing these accounts and will promptly adjust them to allow the credit claimed plus interest. These taxpayers will receive refunds if they have no outstanding debts to the government. We will also review and correct taxpayer accounts that you identified that may have been inappropriately denied refunds.

Your report recognized that under certain conditions the RSED could be extended. One condition that the report emphasizes deals with the financial disability provisions enacted as part of the IRS Restructuring and Reform Act of 1998 (RRA 98). Your report states, "A financial disability is when the taxpayer is unable to manage his or her financial affairs because of a medically determinable physical or mental impairment. The medically determinable physical or mental impairment must be expected to result in death, or have lasted or be expected to last for a continuous period of not less than 12 months. A taxpayer is not considered to have had an impairment unless proof of the existence of the financial disability is provided to the IRS." This definition omits an additional requirement that is critical to correctly interpreting the provision and substantially affects the number of taxpayers potentially eligible for consideration. A taxpayer is not considered financially disabled during any period of time in which a

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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spouse or other person was authorized to act on the taxpayer's behalf in financial matters. A taxpayer seeking relief under the provision of financial disability must provide the IRS with a signed statement that no person, including a spouse, was authorized to act on his or her behalf in financial matters during the period of disability. We believe this information should be reflected in the report.

I believe you will also agree that the number of taxpayers who meet all of the requirements for financial disability would be extremely small. We are confident that our efforts to make the public and practitioner community aware of this provision of RRA 98 are reasonable and appropriate. However, we will modify Letter 105C (Claims Disallowed) to make a general statement that certain situations and conditions may extend the RSED. The letter will refer taxpayers to Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, which explains all the conditions that could extend the RSED. If it is cost effective to do so, we will include that publication with Letter 105C. If it is not cost-effective to include the complete publication, we will develop a separate brochure of the RSED exceptions from the Publication 556.

I agree with the actual and potential benefits listed in the report that are attributable to RSED determinations. However, I disagree with the potential benefits stated as Taxpayer Rights and Entitlements associated with Letter 105C. In our judgment, sufficient sources of information on financial disability are available to taxpayers who may qualify under the stringent requirements.

If you have any questions, please call me or Ronald S. Rhodes, Director, Customer Account Services, at (404) 338-8910.

Attachment



## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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Attachment

### **RECOMMENDATION 1**

The Commissioner, W&I Division, should issue taxpayers' refunds with interest in the 85 instances where we found refunds were inappropriately disallowed before the RSED. To avoid confusion, these taxpayers should be provided an explanation for why the refunds are being issued.

### **CORRECTIVE ACTION**

We agree with this recommendation and have established a process to correct these 85 taxpayer accounts. We will post a credit to each taxpayer's account and issue a refund if there are no unpaid debts to the government. Each taxpayer will be sent a letter explaining why we corrected his or her account.

### **IMPLEMENTATION DATE**

We will correct these taxpayer accounts by September 23, 2003.

### **RESPONSIBLE OFFICIALS**

Director, Accounts Management

### **RECOMMENDATION 2**

The Commissioner, W&I Division, should issue taxpayers refunds with interest for the 227 instances we found where TY 1997 returns were timely received on April 16, 2001, but were inappropriately disallowed. To avoid confusion, these taxpayers should be provided an explanation for why the refunds are being issued.

### **CORRECTIVE ACTION**

We agree with this recommendation and have established a process to correct these 227 taxpayer accounts. We will post a credit to each taxpayer's account and issue a refund if there are no unpaid debts to the government. Each taxpayer will be sent a letter explaining why we corrected his or her account.

### **IMPLEMENTATION DATE**

We will correct these taxpayer accounts by September 23, 2003.

### **RESPONSIBLE OFFICIALS**

Director, Accounts Management

### **RECOMMENDATION 3**

The Commissioner, W&I Division, should request a computer programming change that allows the RSED to accommodate weekends and holidays.

### **CORRECTIVE ACTION**

We agree with this recommendation and will submit a Request for Information Services (RIS) to have the necessary programming changes made prior to calendar year 2006. Calendar year 2006 is the next year during which April 15 falls on a weekend.

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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### **IMPLEMENTATION DATE**

January 15, 2006

### **RESPONSIBLE OFFICIALS**

Director, Accounts Management

### **RECOMMENDATION 4**

The Commissioner, W&I Division, should issue taxpayers' refunds with interest to the estimated 2,830 taxpayers that had their refunds inappropriately disallowed because the Statute Unit employees did not correctly identify appropriate postmark dates before the expiration of the RSED or the IRS-received date was within 7 days after the RSED. To avoid confusion, these taxpayers should be provided an explanation for why the refunds are being issued.

### **CORRECTIVE ACTION**

We agree with this recommendation and have established a process to review the 4,486 TY 1997 returns that were received within 7 days after the RSED. We will correct any taxpayer account having an inappropriately denied refund by posting a credit to the account and refunding it if there are no unpaid debts to the government. Each taxpayer will be sent a letter explaining why we corrected his or her account.

### **IMPLEMENTATION DATE**

Corrections to these taxpayer accounts will be completed by December 12, 2003.

### **RESPONSIBLE OFFICIALS**

Director, Accounts Management

### **CORRECTIVE ACTION MONITORING PLAN**

A special project has been initiated to coordinate the completion of Corrective Actions for Recommendations 1-4. Conference calls and coordination meetings have occurred and will be conducted periodically to ensure timely completion. Branch level management will monitor progress and report to the Director, Accounts Management.

### **RECOMMENDATION 5**

The Commissioner, W&I Division, should evaluate whether an additional control is needed to ensure Statute Unit employees appropriately consider the postmark date and, if no postmark date was available, whether they determined the IRS-received date was within 7 days after the RSED.

### **CORRECTIVE ACTION**

We agree with this recommendation. We will review our current procedures and determine if additional controls are needed.

### **IMPLEMENTATION DATE**

October 16, 2003

## **Taxpayers' Refund Claims Received Near the Refund Statute Expiration Date Were Appropriately Processed, but Enhancements Could be Made**

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### **RESPONSIBLE OFFICIALS**

Director, Accounts Management

### **CORRECTIVE ACTION MONITORING PLAN**

Implementation of this corrective action will be monitored through our internal control system and managerial oversight. Delays in implementation will be reported to appropriate executives.

### **RECOMMENDATION 6**

The Commissioner, W&I Division, should include information in Letter 105C to inform taxpayers that their refund statute could be suspended in the event of a financial disability and refer them to IRS Publication 17 or 556.

### **CORRECTIVE ACTION**

We agree with the intent of this recommendation. We will modify Letter 105C and include a general statement that certain situations and conditions may extend the RSED. We will refer the taxpayer to Publication 556 or to a brochure developed from that publication, which we will enclose with Letter 105C. The brochure will provide information on all the conditions that could extend the RSED.

### **IMPLEMENTATION DATE**

January 14, 2005

### **RESPONSIBLE OFFICIALS**

Director, Accounts Management

### **CORRECTIVE ACTION MONITORING PLAN**

Implementation of this corrective action will be monitored through our internal control system and managerial oversight. Delays in implementation will be reported to appropriate executives.